Do US Firms Have an Incentive to Comply with the FLSA and the NLRA?

Executive Summary. Anna Stansbury, August 2021

Firms have a financial incentive to comply with the law if the expected financial costs of noncompliance – in terms of penalties levied – outweigh the financial benefits in terms of extra profits gained through noncompliance. The Fair Labor Standards Act (FLSA) and National Labor Relations Act (NLRA), as currently written and enforced, do not provide sufficient incentive for firms to comply with the law.

Fair Labor Standards Act

In theory, firms violating the FLSA may incur large costs. Firms have to pay back wages owed to workers and may also have to pay up to an equal amount in liquidated damages. Repeat and/or willful violators may have to pay a civil monetary penalty of up to $2,014 per violation. Goods produced in violation of the FLSA may be embargoed. Willful violators may be criminally prosecuted.

In practice, however, most firms violating the FLSA incur relatively small costs, according to my analysis of data from the Department of Labor and of academic and legal sources.[1] In particular, after DOL enforcement actions most violators only pay the back wages owed to workers, with no liquidated damages or further penalties (only 6% of all violators detected by the DOL pay any civil monetary penalty). This means that for the majority of violators, the financial cost of a violation – if detected – is not much bigger than the profits saved by underpaying workers illegally. Meanwhile, detection is far from certain: many workers are unaware their rights are being violated, or are unable or unwilling to complain, and the DOL's inspection resources are stretched, with less than half the number of inspectors per covered worker than in the 1970s.[2] This combination of low penalties and a relatively low chance of detection means that **for many firms it is profit-maximizing to violate the FLSA**.

A large body of evidence suggests wage theft is very common. For example, one survey of front-line workers in low-wage industries found that 68 percent experienced at least one pay-related violation of federal or state law in any given week, at an average cost of 15 percent of their wages.[3] This is to be expected in an environment where firms have little incentive to comply with the law.

The penalties firms face for underpaying workers - wage theft - are far smaller than the penalties individuals face for theft. In every state, shoplifting goods worth $2,500 or more can lead to felony charges and imprisonment.[4] Wage theft of similar amounts almost never does. The DOL detected more than 66,000 FLSA minimum wage or overtime violations over 2005–16 where the amount underpaid was $2,500 or more. During this period there were only 10 criminal convictions.

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[1] Anna Stansbury (2021). "Do US Firms Have an Incentive to Comply with the FLSA and the NLRA?". PIIE Working Paper 21-9.

[2] Katie Hamaji, Rachel Deutsch, Celine McNicholas, Heidi Shierholz, and Margaret Poydock (2019). "Unchecked Corporate Power: Forced Arbitration, the Enforcement Crisis, and How Workers Are Fighting Back". Economic Policy Institute.

[3] Annette Bernhardt, Ruth Milkman, Nik Theodore, Douglas Heckathorn, Mirabai Auer, James DeFilippis, Ana Luz González, Victor Narro, Jason Perelshetyn, Diana Polson, and Michael Spiller (2009). "Broken Laws, Unprotected Workers: Violations of Employment and Labor Laws in America's Cities". National Employment Law Project.

[4] Amy Traub (2017). "The Steal: The Urgent Need to Combat Wage Theft in Retail". Demos.

Effective deterrence requires higher penalties and detection probabilities. Options include:

- Increasing the deterrent effect across the board, by
  - levying liquidated damages in all cases,
  - increasing the value of liquidated damages to treble damages (as several US states do for minimum wage violations).
- Making penalties substantially higher for serious violators, by
  - increasing the use and magnitude of civil monetary penalties levied by the DOL,
  - extending further the statute of limitations for willful and/or repeat violations,
  - expanding use of the DOL's embargo authority ("hot goods provision"),
  - substantially increasing criminal prosecutions of both firms and individuals,
  - disqualifying company directors after serious violations,
  - making use of public sector suspension or debarment for serious offenders.
- Increasing detection probabilities, by:
  - increasing inspection resources for the Department of Labor's Wage and Hour Division,
  - reforming procedure to make it easier to bring collective actions under the FLSA (like bringing the FLSA in line with other Rule 23 class actions by making the definition of a class opt-out rather than opt-in).
- Reducing avoidance of FLSA liability through employee misclassification, subcontracting, and other alternative employment structures.

Ensuring compliance is particularly important if the federal minimum wage is increased to $15. The higher the minimum wage, the greater the financial incentive for firms to avoid compliance.[5] Without a systematic strengthening of penalties and enforcement, increases in the federal minimum wage will fail to translate into increases in take-home pay for many workers.

National Labor Relations Act

The NLRA only allows for "make-whole" remedies, which compensate workers for their direct losses from a violation. There are no penalties. For example, if a firm dismisses a worker for her union activities, the National Labor Relations Board (NLRB) may require the firm to reinstate the worker and pay her back wages, but no further penalties may be levied. The maximum financial cost to the firm is the cost of paying back wages and hiring a replacement worker. In contrast, the possible financial benefit to a firm of avoiding unionization may be very large (a recent academic study suggests a cost of unionization to shareholders of up to 10% of the firm's equity value).[6] For many firms, therefore, **it would be profit-maximizing to violate the NLRA – even if they knew for certain they would be caught**.

NLRA violations are very common. Over 40% of NLRB representation elections feature unfair labor practice charges.[7] Estimates suggest that one in five union organizers or activists can expect to be fired

[5] Jeffrey Clemens and Michael R. Strain (2020). "Understanding "Wage Theft": Evasion and Avoidance Responses to Minimum Wage Increases". NBER Working Paper No. 26969.

[6] David S. Lee and Alexandre Mas (2012). "Long-Run Impacts of Unions on Firms: New Evidence from Financial Markets, 1961-1999". Quarterly Journal of Economics 127, no. 1: 333-378.

[7] Kate Bronfenbrenner (2009). "No Holds Barred: The Intensification of Employer Opposition to Union Organizing". Economic Policy Institute

during a union organizing campaign.[8] This is to be expected in an environment where the costs of illegal action are small and the potential benefits (to shareholders) are large. Illegal employer opposition to union organizing can help explain the "voice gap" in US workplaces: surveys suggest that half of nonunion workers would vote to join a union, but only 6% of U.S. private sector workers are unionized.[9]

Meaningful deterrence requires substantially higher penalties. Even if firms are certain to be caught violating the NLRA, the cost of doing so is currently so low that many firms still have a financial incentive to break the law. Since the NLRA only allows for make-whole remedies, higher penalties requires new legislation. Options to increase penalties include:

- Increasing the deterrent effect across the board, by
  - awarding unfairly treated workers damages (alongside back pay),
  - removing the deduction for interim earnings from back wage awards.
- Introducing heavy sanctions for more serious violators, by
  - levying large financial penalties,
  - disqualifying company directors after serious violations,
  - making use of public sector suspension or debarment for serious offenders,
  - making possible criminal prosecution in the most serious cases.

The penalties featured in the Protecting the Right to Organize (PRO) Act would make substantial progress on this front. The PRO Act would award workers back pay without a reduction for interim earnings, as well as an equal amount in liquidated damages, and would make possible consequential and punitive damages. It would also introduce civil monetary penalties for unfair labor practice violations up to $50,000 per violation (or up to $100,000 for some repeat violators). However, the fact that for many firms the current financial incentives overwhelmingly favor unfair labor practices means that even a doubling of the expected penalties (e.g. paying back wages plus liquidated damages, vs. paying only back wages) may not have a major impact on the cost-benefit trade-off. **The extent to which the PRO Act would in practice affect employers' incentives to comply will depend most heavily on two discretionary factors:** the degree to which civil monetary penalties and punitive damages are used.

Finally, steps should be taken to ensure that firms cannot avoid labor law liability through superficial changes to their employment structure (like misclassifying workers as independent contractors, or contracting out certain functions). Without addressing this issue, increased incentives to comply with the minimum wage or union organizing protections may simply increase firms' incentive to restructure their employment relationships to avoid legal liability—rather than protecting workers by ensuring firms comply with the law.

Celine McNicholas, Margaret Poydock, Julia Wolfe, Ben Zipperer, Gordon Lafer, and Lola Loustauau (2019). "Unlawful". Economic Policy Institute.

[8] John Schmitt and Ben Zipperer (2009). "Dropping the Ax: Illegal Firings During Union Election Campaigns, 1951-2007". Center for Economic and Policy Research.

[9] Richard Freeman (2007). "Do Workers Still Want Unions? More Than Ever". Briefing Paper 182, Economic Policy Institute.

Thomas A. Kochan, Dunayi Yang, William T. Kimball, and Erin L. Kelly (2019). "Worker Voice in America: Is There a Gap Between What Workers Expect and What They Experience?". ILR Review 72, no. 1: 3-38.